



**REGULAR MEETING**  
**PUBLIC EMPLOYEES' RETIREMENT BOARD**

**JULY 22, 2004**

The regular meeting was called to order by President Teichrow at 8:30 a.m. Thursday, July 22, 2004. Roll call was taken with all members of the Board being present except Carole Carey, who was excused. Board members and staff present were:

Terry Teichrow, President  
Robert Griffith, Member  
Betty Lou Kasten, Member  
Jay Klawon, Member  
Troy McGee, Member  
Jim Pierce, Member  
Kelly Jenkins, Counsel  
Melanie Symons, Counsel  
Mike O'Connor, Executive Director  
Linda Owen, Secretary

**OPEN MEETING**

Dale Taliaferro, AMRPE; Tim Jones and Sue Winchester, Great-West Retirement Services; Terrence M. Smith, Big Sky County Water and Sewer District; Jim Kembel, TIAA-CREF; Perry Christie, Great-West Life; Pam Fleisner, Employee Investment Advisory Council; Blaine C. Bradshaw and Samuel E. Brown, Granite County; Kristi Rosseland, Office of Budget and Program Planning; Rick Ryan, Kurt Bushnell, Chad Nicholson, Jack Trethewey, Mike Anderson, and Ed Regele, members of the Montana State Firemen's Association; and Ian Steel, Disability Claims Examiner; Kim Flatow, Member Services Bureau Chief; Roxanne Minnehan, Fiscal Services Bureau Chief; Kathy Samson, Defined Contributions Bureau Chief; Carolyn Miller, Administrative Officer; Barb Quinn, Accounting Supervisor; Linda Jensen, DC Accountant; and Diana Stitt, Payroll Benefit Technician-DC Plan, PERA, joined the meeting.

**MINUTES OF OPEN MEETING**

The Executive Director presented the minutes of the open meeting of June 24, 2004. Mr. McGee moved that the minutes of the previous open meeting be approved. Mr. Griffith seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

**Public Comment** – Mr. Terry Smith addressed the Board regarding the Defined Contribution Retirement Plan, the Defined Benefit Retirement Plan, and how to achieve plan equity in funding between the two plans.

## **EXECUTIVE DIRECTOR'S REPORT - Mike O'Connor**

**Stable Value Presentation – Arnerich, Massena & Associates** – Scott Faris, CFA, Consultant and Arthur Coyne, CFA, Senior Analyst, at Arnerich, Massena & Associates, presented their analysis on options available to the Board in offering a stable value in the DCRP and the Deferred Compensation Plan.

Mr. Faris reviewed their Statement of Objectives. The MPERA had contracted with Arnerich/Massena to review the stable value option provided in the 457 plan. The Board would like to determine if there is a way to restructure the fund to achieve a higher crediting rate to plan participants by increasing portfolio duration from its current broad market linked target. The Board had suggested two approaches:

- 1) Allocate a portion of assets to a longer duration, using the Montana Board of Investments (BOI) as advisor.
- 2) Increase the duration of the PIMCO portfolio.

To address the Board's question, several factors unique to stable value investing were explored:

- 1) The role stable value has in a retirement portfolio.
- 2) Potential long-term benefit of longer duration.
- 3) Variability of yield spread within the interest rate cycle.
- 4) Absolute and relative crediting rate volatility.
- 5) Participant utilization dynamics.
- 6) Insurance wrap restrictions and what Aegon's underwriting criteria are for stable value.
- 7) Competing stable value crediting rates.

Their conclusion in evaluating the BOI's process and performance was that the Trust Fund Bond Pool the State manages is of very high quality, well structured, with good returns and low risk.

Their recommendation and conclusion is that the trade-off between the potential pickup in yield and all the things competing with that benefit, in their opinion, do not justify moving the duration substantially beyond where it is right now.

Mr. Coyne offered an analysis on the stable value fund and fixed income. He explained that stable value was first developed to be an alternative to money market accounts. Money markets have the appeal of holding a constant value of a dollar without the market value fluctuations. They only have income fluctuations. Could the same thing be done with a bond portfolio, or some sort of mixed fixed income portfolio, moved a little further out in maturity? Money markets are, generally, a year or less in maturity and the shape of the term structure for investing, rewards people for investing for a longer period of time. The benefits of investing for a longer period of time are greatest at the short end---you get a larger premium for the first couple of years, and as the duration extends, the incremental yield becomes less and less. Reigning in that risk is a key part to maintaining stable value.

The insurer, generally, acts as a “watch dog” to insure the various risks. The MPER Board’s wrap provider (Aegon) is the insurer and they are the ones who amortize the gains and losses, do the accounting, and manage the dollar share price. Stable value provides liquidity to the participant and is a great alternative to cash. Generally over the long term, it is going to provide a better return, still have the instant liquidity, low volatility of one’s income, and will have near market returns that are, generally, closer to bond market returns over the long term.

The risk aspect of bonds has to be reigned in, and the stable value portfolio can only take on a certain amount of risk beyond which it can become unstable. It is designed for long-term investment on the part of participants, and a stable value portfolio can break down if participants start gaming the system and market timing, and withdrawing opportunistically and contributing opportunistically. It could not withstand 100% simultaneous participant withdrawal. Plans put restrictions into place to discourage participants and plan sponsors from “yield shopping.”

Historically over the last 42 years, the 5-year Treasury yield has exceeded the 3-year yield by an average of 0.20% annually. In a period of, generally, falling rates, having a longer duration is clearly an advantage. When it is not an advantage is when there are rising interest rates. The BOI’s tenure, as a manager of part of the stable value fund, ran from 1997 into 2001. In general, that was a favorable time to have a longer duration portfolio. Rates were falling rather precipitously, and having a longer duration was a significant benefit. However, that is not always the case.

Stable value crediting rates are not just based on current bond yields, but are really based on trailing bond yields. A 3-year stable value fund is based on the trailing three years worth of bonds. A key point is volatility of the crediting rate—on an absolute basis, the five-year has less volatility of the crediting rate because it has more lag built into it and it moves up and down more slowly. The three-year, on an absolute basis, has more volatility of crediting rate. It moves more quickly because it resets over a shorter period of time. On a relative basis, relative to current market yields in the bond market, the three-year has less relative volatility; the five-year has more tracking error, has larger relative volatility. It is relative volatility and tracking error that give rise to opportunity for participants to market time. That is a hazard that is very important to minimize.

Mr. Coyne reviewed scenarios regarding stable value participant utilization dynamics for near-market duration and long duration, with both falling rates and rising rates.

Mr. Coyne addressed some of the restrictions that are in place to limit market timing, such as keeping the duration under a certain ceiling. Aegon, for example, requires that the duration remain under 5.5 years, which helps keep the price volatility of the collateral in mind.

They asked Aegon what the scenario would be if the BOI’s investment option were introduced. Currently, the limit is four years because of the way PIMCO manages their current bond portfolio. They are not willing to go to 5.5 years. They are only willing to go to four years under the current arrangement. Mr. Coyne stated, as a footnote, that the average duration of stable value funds is 3.48 years, as of the first quarter of 2004.

Mr. Coyle spoke about the advantages and disadvantages of extending the duration. Over the long term, one can expect to pick up extra yield, but there are a number of strings attached to maximizing that. It is not advisable to move out to a longer duration for four reasons:

- 1) market timing by participants which can cause problems for the plan
- 2) setting a different duration target than the market target, it would enlarge MPERA's role in the active management of those funds, and could burden on your time and decision-making abilities
- 3) insurance wrap restrictions
- 4) performance question—are you willing to endure periods of under-performance while having a longer duration

Mr. Coyle addressed the issues of implementing a longer duration strategy:

Option #1 – Allocate a portion of assets to a longer duration, using the Montana Board of Investments as advisor. As it is currently structured, the duration of the Trust Fund Bond Pool is longer than Aegon will allow. They would request a cut back of the current duration. The simplest way the insurer's (Aegon) requirements could be met is to set aside funds in a money market fund for the purpose of bringing the blending money market/TFBP portfolio duration down to a maximum of 5.5 years. This approach increases administrative complexity and would dilute the return advantage that the bond pool might provide via its longer duration strategy.

If the MPERA were to allocate a portion of assets to PIMCO and a portion to the BOI bond pool in order to arrive at some target blended duration, the MPERA would need to be able to develop a reasonable basis for selecting and monitoring its duration target for the blended portfolio. MPERA would have to determine what criteria would be used to determine a duration target, decide whether the target changes as market conditions change, and designate a decision-making authority. Based on prior experience with split-fund administration, MPERA has identified some significant administrative issues that would need to be addressed.

Option #2 – Increase PIMCO's duration. Why would Aegon go to a 5.5-year duration with the BOI, but not with PIMCO? Based on their assessment of the higher-risk strategies and parameters utilized by PIMCO, Aegon will not allow duration to exceed 4.0 years. A simple increase in duration at PIMCO is not feasible.

Or, the Board could consider a combination of the BOI and PIMCO, and having two different money managers. Having only one money manager simplifies things, as there are significant administrative and operational issues associated with having two, but Arnerich, Massena & Associates does not have a problem with the BOI as a money manager.

**James Lewis – Contested Case** – The Supreme Court ruled in favor of Mr. Lewis. The Board discussed the purchasing of the service in question. Staff had calculated what the assessment would be for the service Mr. Lewis wants to purchase.

President Teichrow made a motion that the PER Board approve a service purchase price of \$16,587.79 (including interest), if paid prior to August 7, 2004, for James Lewis' service purchase of 29 months of service credit for the period from November 22, 1977 through March 25, 1980. Payment on or after that date will require additional interest to the time of payment. Mr. Klawon seconded the motion, which upon being submitted to vote, was duly carried with five of the attending members voting aye, and Mr. Klawon voting nay.

**Fiscal Year 2005 Budget** – Roxanne Minnehan presented a line-by-line comparison of the FY 2005/FY 2004 Budget as requested by Mr. McGee. Mr. McGee made a motion to approve the line item review to the FY 2005 budget with the FY 2004 budget. Mr. Griffith seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

**Granite County – Interest Penalty** – Blaine Bradshaw, County Attorney representing Granite County and Samuel Brown, Justice of the Peace, appeared before the Board to discuss interest charges billed to Sam Brown.

Mr. Bradshaw began his presentation. Justice of the Peace Sam Brown became a public official in 1995. Before that, he had worked for the Montana State Prison and was a member of the PERS. The Clerk and Recorder, at that time, argues the position that Judge Brown never explained to her that he was a current member of the PERS. Judge Brown disagrees with that position. The county is requesting that all, or at least part, of the interest be waived by the Board, based on past precedence from this Board.

Mr. Bradshaw explained that in 1999, Judge Brown filled out an Optional Membership Election Form. In that form was a client membership in PERS that also stated if he was an active, inactive, or retired member of PERS. Judge Brown's position is that he was misinformed on that statement. The County was under the impression Judge Brown was not previously a member of PERS and that he could decline membership.

Mr. Bradshaw noted there is a similar situation for Judge Brown and the Town of Philipsburg. While the Town desires to make things right for Judge Brown, the charged interest would be an undue burden on the Town of Philipsburg. They feel the PER Board should also take responsibility in this matter because the Town was never notified that Judge Brown could not decline membership because he was already a member of the system. For these reasons, the county requests a waiver of the interest to be made. Granite County owes \$30,581.00 and the Town of Philipsburg owes \$4,252.63. Both have made a "good faith effort" and paid the balance due. They are hoping for at least a partial refund. Ms. Flatow noted the Town of Philipsburg would be handled separately.

Ms. Flatow gave a brief summary of the case: Samuel Brown was employed with the Department of Corrections and was a member of the Public Employees' Retirement System (PERS). In November 1994, he was elected to the position of Justice of the Peace. Mr. Brown terminated his position with the Department of Corrections on December 30, 1994. He began his employment with Granite County on the first Monday of January 1995.

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Mr. Brown was an active PERS member at that time, and his PERS membership should have continued. He did not have the option to not elect PERS because he was a member through his employment with the Department of Corrections. Mr. Brown applied for and received a refund of his PERS contributions. He did not contribute to PERS through his employment with Granite County or the town of Philipsburg.

In April 2004, Mr. Brown inquired about becoming a PERS member. In the course of the conversation, it was determined that the membership of Mr. Brown was stopped in 1995 in error. Subsequently, a mandatory bill for employee and employer contributions, plus interest, was sent to Granite County and the town of Philipsburg, along with a mandatory bill to collect the refunded contributions. Granite County has made payment in full, but they are asking to have the interest charges waived.

Mr. Klawon pointed out it is the responsibility of the Board to keep the system whole. President Teichrow added it is also the Board's responsibility to correct a mistake if they recognize one. Mr. McGee pointed out that the Board's policy on delinquent contributions and interest is very clear, although he felt it should be changed to allow the Board more flexibility in this area.

Mr. Klawon made a motion to uphold the previous Board decision, denying the request of the Granite County to waive all interest charges in the matter of Samuel Brown. Mrs. Kasten seconded the motion, which upon being submitted to vote, was duly carried with Mr. Klawon, Mrs. Kasten, Mr. Pierce and President Teichrow voting aye, and Mr. Griffith and Mr. McGee voting nay.

Mr. McGee made a motion to review the Board's policy regarding interest charges on errors. Mr. Griffith seconded the motion, which upon being submitted to vote, was duly carried with five of the attending members voting aye, and Mr. Klawon voting nay.

**Board Policies Update** – The Board was advised that Mr. O'Connor would be replacing Keith McCallum on the policy committee. Next month the committee will present the interest penalty policy.

Ms. Symons presented Policy D10-95 - Disability Investigator, which had no substantive changes, only policy formatting changes. Mr. Klawon made a motion to adopt the Disability Investigator policy as amended. Mr. McGee seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

Ms. Symons presented Policy GB7-95 – FLO-Charge for Excessive Use of Time, which had policy formatting changes. Staff will determine when they are using "excessive" time on FLO's, and tracking of time will need to be done. Mr. McGee made a motion that the Board adopt the proposed amended FLO-Charge for Excessive Use of Time policy. Mr. Klawon seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

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**Out of State Travel Authorization** – The Board was requested to authorize out of state travel for Rob Virts to attend the National Association of Government Training and Development (NAGTD) Conference in Asheville, North Carolina, September 26-30, 2004. Mr. McGee made a motion to approve the NAGTD meeting travel request. Mr. Griffith seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

**Out of State Travel Authorization** – The Board was requested to authorize three staff and three Board members to attend the National Association of State Retirement Administrators (NAGDCA) Annual Conference in Salt Lake City, Utah, September 11-15, 2004. Mr. Klawon made a motion to approve the out of state travel request. Mrs. Kasten seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

**Legal Service Contract – Ice Miller** – The Board was presented with an addendum to the contract for legal services with Ice Miller. The purpose of the addendum is to extend the termination date of the original contract from July 1, 2004 to June 30, 2005. The terms and services of the agreement remain unchanged, except the following:

- 1) The scope of duties shall be expanded to include the defined contribution plan and the deferred compensation plan;
- 2) The charges under 6.2 shall be based on the current hourly fee schedule with the 15% discount applied; and
- 3) The scope of duties will include a presentation to the PER Board on fiduciary responsibilities at a cost not to exceed \$5,000.

Mr. McGee had a problem with item #3, questioning how many times the Board needs a presentation on fiduciary responsibility. Mr. O'Connor pointed out there are new Board members who have not been privy to any fiduciary presentations; however, those Board members did not feel it was worth \$5,000. The Board recommended Mr. O'Connor contact Ice Miller to rewrite the contract without item #3, and bring it back to the Board for approval.

**Contested Case Update - Lorraine Houppert** – Mr. Jenkins stated the claimant is requesting judicial review of the hearing examiner's decision. The Board needs to file with District Court. Because of the precedent this case would set, Mr. Jenkins would rather get the statute clarified with current understanding than work through it in court. At this time, he is not proposing to agree or disagree. Mr. Jenkins stated he is not prepared to discuss details, but settling will be considered.

**Joseph Baumgardner** – The case is a matter of some public interest. The District Court decision went against the Board on a question of whether the legislature unconstitutionally gave the Board legislative authority over setting of actuarial rates. The Court did not reach what was thought to be the core issue of the case: whether the legislation that allowed the Board to change the mortality table actuarial assumption was an impairment of contract.

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The general feeling is that it is senseless to continue at the District Court level if there is an alternative that allows the Supreme Court to clarify some of these issues. Litigation strategy will be discussed in closed session on whether the Board wants to go to the Supreme Court for clarification on the legislative delegation issue and on the impairment of contract issue. In the meantime, there has been a flurry of motions from the other side and other minor things going on in District Court. Mr. Jenkins feels the Board would be best served by getting clarification at the Supreme Court level.

**Future Board Meetings** - Thursday: August 26 and, tentatively, September 23, 2004.

President Teichrow made a motion to have the September Board meeting in Miles City, with the date pending the availability of the Governor's plane. Mr. Griffith seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

**Miscellaneous** – On behalf of the Montana State Firemen's Association (MSFA), Mike Anderson thanked Mr. O'Connor for attending their Annual Firefighters' Convention in Kalispell, July 15-16, 2004. Mike advised the Board Kurt Bushnell would be the new MSFA President. He also introduced two new MSFA members, Ed Regele from Billings and Jack Trethewey from Havre.

**The following portion of the meeting relates to matters of individual privacy. President Teichrow determined that the demands of individual privacy clearly exceed the merits of public disclosure. As such, this portion of the meeting will be closed.**

#### **CLOSED MEETING**

#### **MINUTES OF CLOSED MEETING**

The Executive Director presented the minutes of the closed meeting of June 24, 2004. Mr. Klawon moved that the minutes of the previous closed meeting be approved. Mr. McGee seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

**RETIREMENT REPORT** - Ian Steel, Disability Claims Examiner

**Disability Claims** - The Disability Claims Examiner presented the disability claims for Board consideration.

Mr. Pierce made a motion for approval of the disability claims as recommended for Gerald Newbury, without annual review; and denying the claim for Theodore Druschel. Mr. McGee seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.



**Disability Reviews** - The Disability Claims Examiner presented the disability reviews to the Board.

After discussion of all the reviews, Mr. Pierce made a motion to approve the disability reviews as recommended: to continue disability retirement and continue annual review for James Zadra; to continue disability retirement and discontinue annual review for Edward D. Jackson, Bernard L. Bodt, Sara Preece, and Joyce Sample; and requesting an IME at the Board's expense for Jerome Stradinger. Mr. Griffith seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

**Finalized Service/Disability Retirement Benefits, Monthly Survivorship/Death Benefits, and VFCA Lump Sum Death Benefit Payments** - Applications for service retirements/finalized disability benefits, applications for monthly survivorship-death benefits, and VFCA lump sum death benefit payments were presented to the Board. Mr. Griffith made a motion to approve the retirement benefits as presented. Mr. Pierce seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

## **CONTESTED CASES**

**Diane Andrews - Informal Consideration** – Diane Andrews is requesting the Board to make an initial determination regarding the denial of a financial hardship withdrawal for the participant/petitioner from the 457 deferred compensation plan.

Mrs. Kasten made a motion that the Board uphold the determination of the Emergency Withdrawal Committee denying Diane Andrews' request for a financial hardship withdrawal from her 457 deferred compensation account. Mr. Klawon seconded the motion, which upon being submitted to vote, was duly carried with five of the attending members voting aye, and President Teichrow abstaining.

**Robert Barry – Informal Consideration** – Mr. Barry is disputing the computation of his Highest Average *monthly* Compensation (HAC) during 36 consecutive months of membership service. He wants a computation based on his part-time hourly salary. Staff determination is that the HAC is dependent upon the monthly compensation a member receives, not the hourly rate or the total number of hours worked. He is in a defined benefit plan and retirement benefits are calculated based on a standard formula.

Mrs. Kasten made a motion that the Board uphold staff determination in the computation of the HAC for Robert Barry. The HAC is computed in accordance with statute. Mr. Klawon seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

**Contested Case Report Update** – Joseph Baumgardner – The Board agreed to have Mr. Jenkins file a Writ, addressing the issues.

**Richard/Diane Patera – Informal Consideration** – After much discussion at the May meeting, the Board determined that the newest membership card was timely filed and should be the controlling membership card. Mrs. Patera is appealing the Board's decision regarding which membership card should control. She is requesting they review this case again, and that the initial card should control.

Following review of the case, Mr. McGee made a motion that the Board determine that the membership card dated March 31, 2004, was not timely received by the Board and that the membership card dated May 5, 1993, naming Diane Patera as the designated primary beneficiary, controls. Mr. Klawon seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

**The closed meeting was recessed and the open meeting was reconvened.**

**Joseph Baumgardner** - President Teichrow made a motion to file an application for a Writ of Supervisory Control, as Mr. Jenkins suggested. Mr. Klawon seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

## **ADJOURNMENT**

There being no further business to come before the Board at this date, Mrs. Kasten made a motion to adjourn the meeting. Mr. Klawon seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye. The next meeting is tentatively scheduled for August 26, 2004, at 8:30 a.m. in Helena.